

## ALTERNATIVE FORECASTS

DRI has assigned a 50% probability of occurrence to its March 2001 baseline forecast of the U.S. economy. The major features of this forecast include:

- Real GDP advances 5.0% in 2000, 1.7% in 2001, 3.3% in 2002, 4.4% in 2003, and 4.0% in 2004;
- U.S. nonfarm employment increases 2.0% in 2000, 0.5% in 2001, 0.8% in 2002, and 1.7% in 2003, and 1.7% in 2004;
- the U.S. civilian unemployment rate peaks at 5.3% in 2002, then eases to 4.7% by 2004;
- consumer confidence falls below 90 in 2001, but recovers and approaches 100 by 2004;
- consumer inflation is 2.7% in 2001, then hovers just under 2.0% in the remaining years of the forecast;
- and the U.S. merchandise trade deficit swells to over one-half trillion dollars by 2004.

While the baseline scenario represents the most likely path for the national economy over the next few years, uncertainties surrounding several key variables mean other outcomes are also possible. To account for this, DRI prepares alternative forecasts based on different assumptions regarding these key variables. Two of these alternative forecasts, along with their likely impacts on the Idaho economy, are discussed below.

The odds of the U.S. economy entering a recession have increased. Both of the alternative scenarios prepared by DRI include recessions. The *Late Recession Scenario* has been assigned a 10% probability of occurrence. The aptly titled *Pessimistic Scenario* has been given a 40% probability of occurrence. This implies a combined probability of 50%. Put another way, the odds are even that U.S. economy will experience a recession over the next few years.

### LATE RECESSION SCENARIO

DRI's *Late Recession Scenario* has been assigned a 10% probability of occurrence. This scenario explores the consequences of the Federal Reserve overreacting to the current slowdown. In an effort to keep the economy moving, the central bank lowers interest rates aggressively. This scenario also assumes tax cuts occur in 2002 and 2003, providing further fuel for growth. This stronger growth raises inflation pressures. In addition, oil prices begin to rise, providing more fuel to inflation. By late 2003, inflation cannot be ignored. Consumer prices are soaring at a 5.0% annual rate. The Federal Reserve tightens sharply to control inflation in an overheated economy. The sharp rise in rates disrupts the flow of credit and brings the stock market down with a thud. Consumers turn pessimistic as high interest rates put mortgages out of reach and jobs evaporate.

The Federal Reserve's policy works too well; the economy slides into a four-quarter recession in 2004. Over that year, real output shrinks 2.6%. The unemployment rate peaks at 7.1% in the spring of 2005. The stock market declines by 35%. The Federal Reserve quickly reverses course after the recession begins. The economy recovers, with real GDP growth exceeding 4% in both 2006 and 2007. The general pattern is similar to the Federal Reserve's performance after the 1987 stock market crash, when it loosened sharply after the crash, but then got whipsawed when the economy reaccelerated.

**IDAHO ECONOMIC FORECAST**  
**BASELINE AND ALTERNATIVE FORECASTS**  
**APRIL 2001**

	BASELINE				LATE RECESSION				PESSIMISTIC			
	2001	2002	2003	2004	2001	2002	2003	2004	2001	2002	2003	2004
<b>GDP (BILLIONS)</b>												
Current \$	10,350	10,862	11,513	12,169	10,371	10,997	11,709	12,064	10,172	10,686	11,321	11,926
% Ch	3.9%	4.9%	6.0%	5.7%	4.1%	6.0%	6.5%	3.0%	2.1%	5.1%	5.9%	5.3%
1996 Chain-Weighted	9,475	9,784	10,210	10,615	9,497	9,885	10,313	10,279	9,321	9,661	10,092	10,478
% Ch	1.7%	3.3%	4.4%	4.0%	1.9%	4.1%	4.3%	-0.3%	0.0%	3.7%	4.5%	3.8%
<b>PERSONAL INCOME - CURR \$</b>												
Idaho (Millions)	32,424	34,140	36,259	38,541	32,441	34,323	36,606	38,350	32,220	33,837	35,967	38,071
% Ch	5.0%	5.3%	6.2%	6.3%	5.0%	5.8%	6.7%	4.8%	4.3%	5.0%	6.3%	5.8%
U.S. (Billions)	8,652	9,046	9,561	10,083	8,661	9,123	9,722	10,115	8,523	8,868	9,392	9,877
% Ch	4.5%	4.6%	5.7%	5.5%	4.6%	5.3%	6.6%	4.0%	2.9%	4.0%	5.9%	5.2%
<b>PERSONAL INCOME - 1996 \$</b>												
Idaho (Millions)	29,627	30,711	32,092	33,530	29,627	30,676	31,720	32,070	29,462	30,516	31,950	33,325
% Ch	3.0%	3.7%	4.5%	4.5%	3.0%	3.5%	3.4%	1.1%	2.4%	3.6%	4.7%	4.3%
U.S. (Billions)	7,906	8,137	8,462	8,772	7,910	8,154	8,424	8,459	7,794	7,998	8,343	8,646
% Ch	2.5%	2.9%	4.0%	3.7%	2.5%	3.1%	3.3%	0.4%	1.0%	2.6%	4.3%	3.6%
<b>TOTAL NONFARM EMPLOYMENT</b>												
Idaho (Thousands)	567.4	577.2	590.3	605.4	567.6	578.5	590.1	591.5	565.2	574.0	588.7	602.9
% Ch	1.5%	1.7%	2.3%	2.6%	1.6%	1.9%	2.0%	0.2%	1.1%	1.6%	2.6%	2.4%
U.S. (Millions)	132.0	133.1	135.4	137.7	132.2	134.0	136.8	136.3	129.9	130.8	133.5	136.0
% Ch	0.5%	0.8%	1.7%	1.7%	0.6%	1.4%	2.0%	-0.3%	-1.2%	0.7%	2.1%	1.9%
<b>GOODS PRODUCING SECTOR</b>												
Idaho (Thousands)	115.7	117.4	119.8	122.6	115.9	118.9	121.8	120.2	114.2	116.2	119.5	121.8
% Ch	-0.2%	1.5%	2.1%	2.3%	0.0%	2.6%	2.4%	-1.3%	-1.5%	1.8%	2.8%	2.0%
U.S. (Millions)	25.1	24.5	24.5	24.7	25.2	25.0	25.4	24.8	24.7	24.0	24.2	24.5
% Ch	-2.1%	-2.5%	0.0%	0.8%	-1.8%	-0.9%	1.5%	-2.2%	-3.8%	-2.9%	1.1%	1.1%
<b>SERVICE PRODUCING SECTOR</b>												
Idaho (Thousands)	451.7	459.8	470.5	482.9	451.7	459.6	468.3	471.3	451.0	457.7	469.2	481.1
% Ch	2.0%	1.8%	2.3%	2.6%	2.0%	1.7%	1.9%	0.6%	1.8%	1.5%	2.6%	2.6%
U.S. (Millions)	106.9	108.6	110.9	113.0	107.0	109.1	111.4	111.5	105.2	106.8	109.3	111.5
% Ch	1.1%	1.6%	2.1%	1.9%	1.2%	2.0%	2.2%	0.1%	-0.5%	1.5%	2.3%	2.0%
<b>SELECTED INTEREST RATES</b>												
Federal Funds	5.1%	4.8%	5.3%	5.5%	4.9%	4.7%	6.5%	6.4%	4.7%	4.3%	5.3%	5.5%
Bank Prime	8.1%	7.8%	8.3%	8.5%	7.9%	7.7%	9.5%	9.4%	7.7%	7.3%	8.3%	8.5%
Existing Home Mortgage	7.0%	7.3%	7.7%	7.9%	6.9%	7.2%	8.6%	9.3%	6.9%	7.0%	7.8%	8.0%
<b>INFLATION</b>												
GDP Price Deflator	2.1%	1.6%	1.6%	1.7%	2.1%	1.9%	2.1%	3.4%	2.0%	1.4%	1.4%	1.5%
Personal Cons Deflator	1.9%	1.6%	1.6%	1.7%	2.0%	2.2%	3.1%	3.6%	1.9%	1.4%	1.5%	1.5%
Consumer Price Index	2.7%	1.8%	1.6%	1.8%	2.8%	2.4%	3.2%	3.7%	2.7%	1.6%	1.5%	1.5%

**Forecast Begins the FOURTH Quarter of 2000**

In this scenario, Idaho's economy initially grows faster than its baseline counterpart, but weakens in the latter years of the forecast due to the late recession. Specifically, Idaho nonfarm employment advances 1.6% in 2001 and 1.9% in 2002. In the baseline, this same measure rises 1.5% in 2001 and 1.7% in 2002. Idaho real personal income grows 3.0% this year and 3.5% next year. It increases 3.0% in 2001 and 3.7% in 2002 in the baseline. In the latter half of the forecast horizon, the cooling U.S. economy takes its toll on the Idaho economy. Both Idaho job and real personal income growth slow significantly, eroding their advantage over their baseline counterparts. By 2004, Idaho nonfarm employment is about 14,000 lower than in the baseline and real personal income is off by over \$450 million.

## **PESSIMISTIC SCENARIO**

The Federal Reserve successfully pulls off a soft landing in the baseline scenario. Both of the alternative scenarios assume the nation's central bank fails to avoid a recession. The major difference between the two is the timing of the recession. In the *Pessimistic Scenario* the recession comes sooner than later. It is the most likely of the two alternatives, with a 40% probability of occurrence. In this scenario, the recession that is already gripping the manufacturing sector spreads to the entire economy. Business confidence has eroded as overly optimistic projections have left business with swollen inventories. This, along with the ongoing stream of disappointing business earning reports, put a crimp in business investment. Consumer confidence, which is already reeling from the stock market slide, is further distressed by the uncertainty created by high energy bills and the softer job market. As a result, we enter a recession in the beginning of 2001.

The Federal Reserve reacts quickly once it sees the landing is turning hard. The Federal Reserve accelerates its interest rate reductions. With energy prices in retreat, it has no reason to hold back. Thanks to quick action on the Federal Reserve's part, the damage to the economy is contained, and by the last quarter of 2001, the economy is growing once again. The mildness of this downturn hinges primarily on a quick resumption of credit flows, stable energy prices, and continuing improvements to utilize emerging technologies. Should any of these assumptions not hold, the recession would be considerably more painful.

Because the national recession is relatively minor, it has a slight negative impact on the Idaho economy. In this scenario, Idaho nonfarm employment rises 1.1% in 2001. This is 40 basis points below the projected 1.5% growth in the baseline. There are about 1,500 fewer goods-producing jobs and about 700 less services-producing jobs in 2001. The personal income measures, both nominal and real, grow slightly slower than their baseline counterparts in 2001. Idaho nonfarm employment is about 2,500 lower than in the baseline in 2004 and real personal income is down about \$200 million.